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SUBJECT: Update on Banking Sector Reform in Vietnam

REF: HANOI 1149

¶1. (SBU) Summary: State Bank of Vietnam (SBV) officials believe their efforts to reform the banking sector have put it on a firm path toward international standard supervision. However, they tried to distance themselves from the equitization process (over which they should have at least supervisory authority) and have not developed good mechanisms for cooperation on supervision of non-banking financial services. Banking supervisors pushed for the United States to allow Vietnamese banks to enter the United States, and asked for specific feedback on any shortcomings in their anti-money laundering regime. End Summary.

¶2. (SBU) This is one of five cables reporting on Regional Financial Attache Susan Baker's May 29-June 1 visit to Vietnam. This message reports her findings and impressions of the banking sector.

SBV'S REFORM EFFORTS

¶3. (SBU) SBV officials framed a discussion with FinAtt by explaining their role is both regulating and managing the banking system. They acknowledge that credit growth is relatively high, but argue that high lending is needed to support strong GDP growth. They expect to face the challenge of high growth by controlling risks, lowering non-performing loans (NPLs) and pushing for better compliance with stricter rules for loan classification and provisioning.

¶4. (SBU) Indeed, some official sources argue that the VND 11 trillion (roughly $700 million) that has been spent recapping the state-owned banks and the reduction in reported NPLs have put the Vietnamese banking sector on a much stronger footing than countries such as China. Others remain concerned about the contingent liabilities presented by state-owned financial institutions and poor enforcement of asset quality classification standards.

LENDING FOR SECURITIES

¶5. (SBU) One area the regulators clearly are concerned about is bank lending for securities trading, particularly stock market speculation. Reacting to the run-up in the stock exchange, the SBV increased the risk weighting on securities lending to 150 percent (vs. 100 percent for corporate lending), meaning that banks would have to set aside capital equivalent to 12 percent of any securities loan (vs. 8 percent for corporate loans). Furthermore, the regulators advised the banks to cap their lending for securities purchases at 3 percent of their overall lending portfolio. Banks are also limited in the amount of loans and equity investments they can give to securities companies.

¶6. (SBU) While relatively strict on the asset side, SBV officials do

not seem to appreciate the operational risks that might be involved in allowing banks to operate securities businesses, especially those (such as order-taking businesses) that are not supervised by the State Securities Commission (SSC). SBV officials and private bankers both acknowledge that the bank regulators and the securities regulators are not communicating about potential conflicts or undertaking a consolidated supervision approach. Both local banks FinAtt met volunteered that they want to expand their non-banking financial services into securities and insurance.

VIETNAMESE BANK ENTRY INTO THE UNITED STATES

¶7. (SBU) SBV banking policy officials made a clear request for approval of three applications for Vietnamese banks to enter the United States. They recognize that it is important for foreign institutions to be vetted by host authorities before establishment, but insist that the Vietnamese banks should be allowed to open in the United States. FinAtt explained that the Federal Reserve has the legal authority to determine whether banks can enter the U.S. market and generally bases its decision on its determination that the bank has sufficient capital, is subject to comprehensive consolidated supervision, and has a strong anti-money laundering regime, as well as on its consideration of other prudential matters.

¶8. (SBU) The Vietnamese pressed their case by noting that all Vietnamese applicants have been restructured and recapitalized, using its new international standard classification system. (Note: Two of the banks have not yet even been "equitized" so are not yet recognized as separate corporations. End note.) The SBV believes it has risk-based, consolidated supervision, particularly noting its work with foreign supervisory authorities to implement the Basel Guidelines for Bank Supervision. Finally, they note their recent

admission to the Asia Pacific Group, a regional anti-money laundering (AML) organization, as evidence of their commitment to a strong AML regime. (Note: SBV officials will be meeting with the appropriate Federal Reserve Board staff to discuss this issue in mid-June.)

EQUITIZATION OF STATE-OWNED BANKS

¶9. (SBU) FinAtt noted that a fundamental concern about the current structure of Vietnam's banking system is the lack of separation between ownership and supervision of the state-owned commercial banks (SOCBs), which currently account for nearly three-fourths of the banking system's assets. The SBV officials stated that technically the capital for the SOCBs comes from the MOF, and as such the MOF is the "owner" of the banks. Regardless, they feel that after the "equitization" process, where banks are transformed into corporations and shares are sold to employees and others, that any concerns about conflicts between supervisor and owner should be completely mitigated. They tried to make their case by saying they are not in charge of the "equitization" process of the state-owned banks. They said the bank itself has to develop its own plan, which would be approved by the Steering Committee on Enterprise Reform, of which SBV was only one member, alongside the MOF and the Office of Government.

¶10. SBU) Vietcombank and Mekong Housing Bank are scheduled to be equitized this year (note: one year behind schedule). The Bank for Investment and Development of Vietnam (BIDV) and the Vietnam Bank for Agriculture and Rural Development (Agribank), two other large state-owned commercial banks, are expected to follow next year. Regulators agree on the importance of a public listing of the banks to help inform their regulatory efforts. They highlight that many banks had entered into advisory contracts to try to get a good price for when they sold shares; however, these advisors are barred from taking a pre-IPO financial stake in the bank.

FOREIGN INVESTMENT IN BANKING SECTOR

¶11. (SBU) With regard to the state-owned banks and other equitizing companies, Vietnamese policy seems to be moving toward requiring all strategic investors to buy their stakes at the IPO price at the same time as the IPO. While SBV officials and bankers appreciate the fact that strategic partners with equity stakes would have more of an interest in implementation of reforms than pure consultants and could help garner a higher price at listing, a few officials noted rising concern about "selling too cheap" to foreigners.

¶12. (SBU) Some British and Australian banks, several foreign private equity funds and international institutions such as the IFC already have moved in to take minority stakes in Vietnamese banks. Earlier in 2007, the Prime Minister declared that while total foreign ownership in local banks would remain capped at 30 percent, individual stakes could go as high as 15 percent (or 20 percent with special permission) compared with 10 percent previously. Under its WTO commitments, Vietnam was supposed to allow 100 percent foreign-owned banking subsidiaries upon accession, but it has not yet issued the guidelines to implement approvals. Bankers note that the SBV is expected to ask for information-sharing arrangements to be formalized with home country supervisors before banks can establish their subsidiary. Australian regulatory authorities have already complied with this expected requirement.

¶13. (SBU) Comment: It is worrisome that the banking regulators say they have developed a strong supervisory regime while at the same time trying to disavow any control or influence over the equitization and privatization process. They still seem to be advocating on behalf of their banks rather than supervising them to ensure adequate capital, corporate governance and risk management. Lack of appreciation for operational risks of unsupervised securities activities by banks also does not bode well for their ability to manage banking sector exposure to the stock market. End Comment.

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